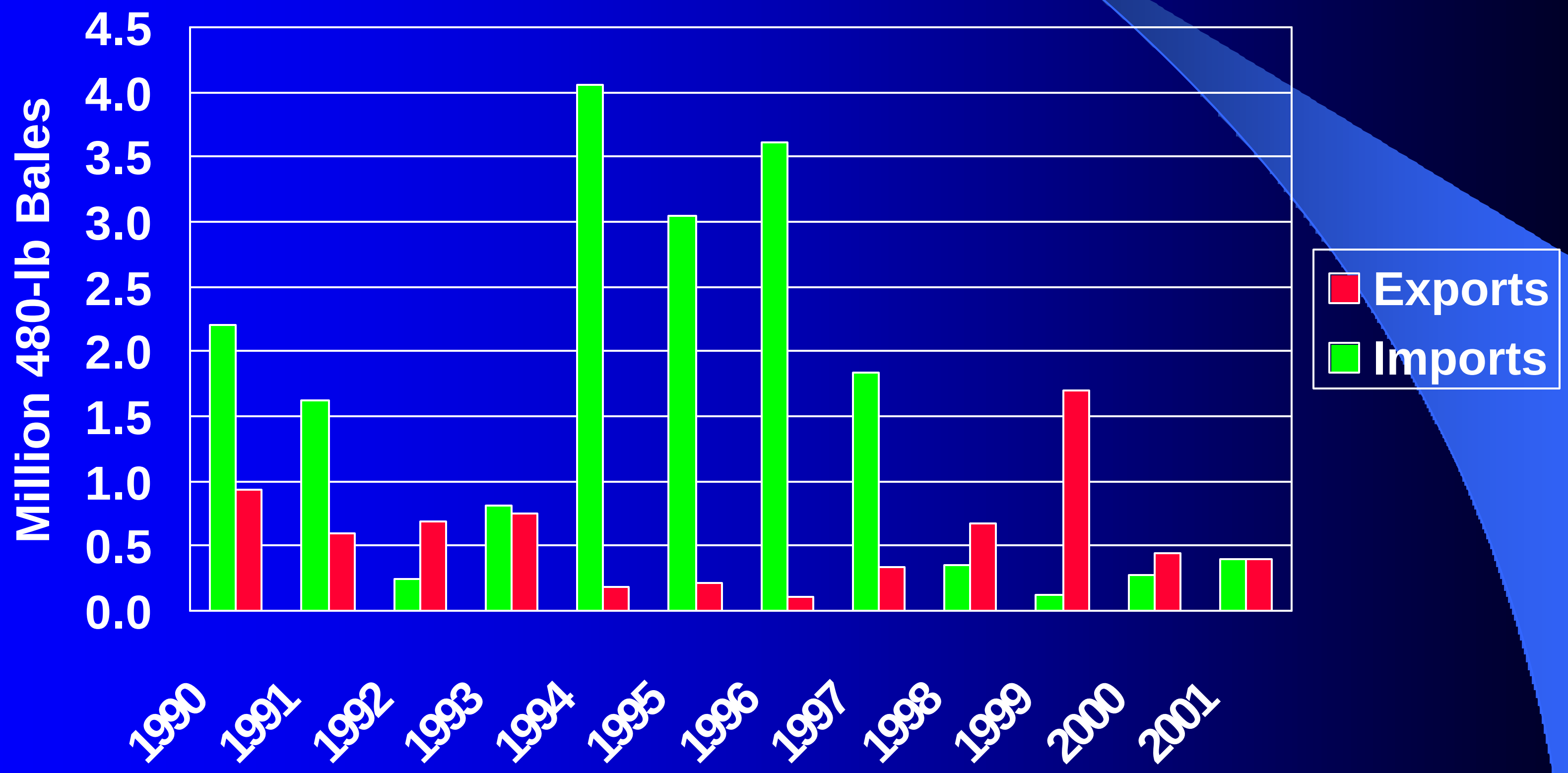
China's Cotton Trade Under the WTO

Hunter Colby
Globecot

Why Do We Care?
Potential for Large Net Imports



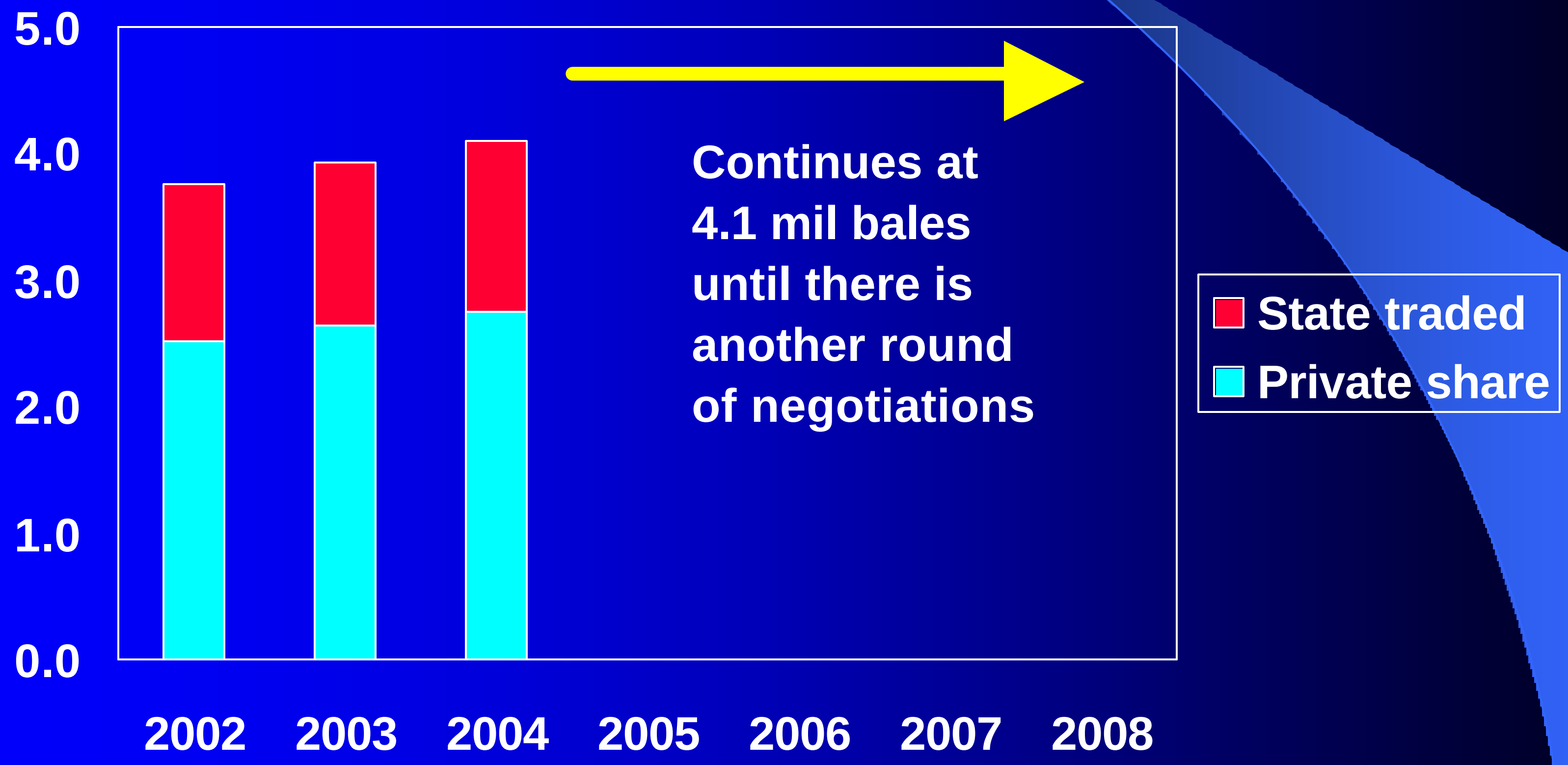
What Does WTO Accession Mean for China's Cotton Trade?

- Examine new trading rules
- Envision how practical application of those rules may proceed
- Speculate on impact on China's cotton trade over the short and medium term

Timeline

- China accedes to WTO on December 14, with implementation of commitments to take effect on January 1, 2002.
  - Tariff-rate quota system for cotton imports
  - Cotton export subsidies banned
  - Domestic cotton marketing and distribution services liberalized

China's Cotton Quota Limit



Tariff Rate Quota System

- Up to 818,500 tons in CY2002 at 1%
  - Above quota tariff at 54.5 %
  - Two-thirds of quota to non-state trade, remaining one-third to state trade
  - Quota rises to 894,000 tons in 2004
    - Above quota tariff declines to 40 %
  - Unused state quota reallocated by Oct 1

Export Subsidies

- China committed to end use of all cotton export subsidies upon accession
  - Successfully used in past, most recently to promote exports of Xinjiang cotton
  - VAT rebates, if do not exceed actual VAT rate, will likely continue as they do not seem to come under this provision

Distribution Services

- Phase in rights to cotton distribution over three years
  - Year 1: Foreign invested ventures may distribute domestic cotton
  - Year 2: Foreign invested ventures may distribute domestic or imported cotton
  - Year 3: All ventures, including wholly foreign owned, may distribute cotton from all sources

Rules for TRQ Cotton Imports

- Apply for quota Feb 10-21
- Notified of allocation by Mar 5
  - Significant delay from Jan 1 start
  - Factor in enlisting trade company, arranging purchase, and transit time, first TRQ imports may not land until early April
  - One-fourth of calendar year gone, and only four months of MY 2001/02 remaining

China Imposes Surprise Rule

- Quota and application process split between “general trade” and “processing trade”
  - May be a problem in future if impedes trade
  - How balance allocation if one type is over-subscribed and other is under-subscribed
  - Language in rules for process trade access to quota very unclear, difficult to assess impact

Criteria to Determine if End Users May Apply for Quota

- To be able to apply for quota, must meet at least one of the following criteria:
  - State-trading company (Chinatex, etc.)
  - Central government enterprise that can hold state cotton reserves
  - Imported cotton in 2001
  - A yarn mill with more than 50,000 spindles

Allocation of Quota

- Allocation principles in order of precedence
  - End users with a “history of imports”
  - “Processing capacity and business volume”
  - Additional factors impacting allocation:
    - “production, sales, experience, capability of providing services on the international market”
  - Allocations below an unstated “threshold” will not receive any quota

Implications of the Application Criteria?

- Notable bias towards state-enterprises…
  - State cotton trading company
  - Gov’t institution holding state cotton reserves
  - History of imports…if gauge is 2001, few meet criteria as imports only 230,000 bales, and primarily are state-owned mills (some JVs)
  - 50,000+ spindle mill….only larger mills qualify, again mostly state-owned enterprises

How Many Mills Qualify?

- Unable to research numbers, but likely not a large share of the total universe of China's yarn mills
  - 50,000 spindles running 12/7 for 50 weeks, means consume roughly 25,000 bales a year
  - Excludes township and village spinning operations
  - An important limiting factor…will this promote consolidation in future?

What is Not Mentioned…

- Spindle language is confusing…
  - Does this exclude all non-woven enterprises?
  - What about open-end spinners who don’t have spindles?
  - Spindles “registered,” but underreporting rampant to avoid gov’t drive to reduce capacity
- Wiggle room for gov’t, or just an oversight?
- Excludes foreign firms w/out a yarn mill

Distribution Services

- China must allow foreign-funded enterprises to compete in the cotton marketing and distribution system
- System already in flux with two unilateral rounds of liberalization (1999 and 2001) of SMC/CJC system

Current State of Distribution

- Mixed picture depending on province
  - Hebei officials more aggressive, approved over 700 firms to participate in procurement and marketing, though many are simply repackaged versions of CJCs
  - Xinjiang approved less than 30 enterprises
- Many impediments to moving into this business…particularly access to credit

Impact of Distribution Reform

- In short order (3 years), China's domestic cotton marketing system is likely to be faced with wholly foreign-owned competitors….perhaps some of the larger U.S. merchants
- Current system relatively weak and fractured
  - Lack of credit, overstaffed, etc.

Implications of WTO for China's Cotton Trade

- USDA currently estimating 400,000 bales of imports in 2001/02
- Some imports likely to occur very quickly, if only for PR reasons
- Unlikely to see big volumes this mktg year
  - Delay in establishing TRQ system
  - Navigate a Byzantine and untried TRQ system

Real Question is 2002/03

- Birthing pangs of new system over?
  - Cotton production may fall 15-20 percent as recent intentions survey suggest
  - But large stock overhang from 2001/02 unless consumption growth stays high
  - Imports likely above this year, but not reaching TRQ limit

So Many Questions….
So Few Answers

- A more realistic projection of imports under the new TRQ system in 2002/03 must wait for the system to actually function
- Important questions remain…
  - Non-mill sector access to quota
  - Allocation principle not clearly defined

One Person's WAG…

- In 2002/03, total imports could rise to between 1.5 and 2 million bales
  - Assume at least 10 percent decline in output, and continued growth in offtake
  - Optimistic?…rules may limit access to TRQ
  - Impact of plan to purchase for state reserves?
  - Need see TRQ system actually operate for a while